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UNCLAS SECTION 01 OF 02 HANOI 002309

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USDOC FOR 4430/MAC/ASIA/OPB/VLC/HPPHO
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USDOE FOR INTERNATIONAL AFFAIRS/DPUMPHREY

E.O. 12958: N/A

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SUBJECT: VIETNAM: PETROLEUM PRODUCT PRICE HIKE FUELS
INFLATION

1. Summary: The Government of Vietnam (GVN)'s USD 400 million subsidy of gasoline and petroleum products in the first six months of this year has made a significant dent in the budget. To reduce pressure on the National Government budget at a time of high oil prices, the GVN has raised the prices of petroleum products for domestic use. According to the Ministry of Finance (MOF), this price hike will boost costs in sectors using petroleum products as inputs and will likely boost inflation. The availability of gasoline and other petroleum products at subsidized prices in Vietnam has resulted in product smuggling to China, Cambodia and Laos. END SUMMARY.

2. According to Vietnam's Ministry of Finance (MOF), the Government has spent about VND 6,454 billion (about USD 406 million) subsidizing gasoline and petroleum products in the first six months of this year. MOF eliminated import tariffs on petroleum products on March 17, 2005 in an attempt to curb price increases in Vietnam. The subsidy coupled with tariff cuts has resulted in a significant loss in GVN budget revenue. In order to reduce pressure on the Government budget in a period of high world oil prices, the GVN has raised the prices of gasoline and petroleum products twice in two months. Following an increase on July 3, consumers paid the following prices:

Category	Former Price (VND/liter & USD)	July 3rd Price (VND/Liter & USD)
Gasoline Octane 92	8,000 (\$0.51)	8,800 (\$0.55)
Gasoline Octane 90	7,800 (\$0.49)	8,600 (\$0.54)
Gasoline Octane 83	7,600 (\$0.48)	8,400 (\$0.53)
Diesel	5,500 (\$0.35)	6,500 (\$0.51)
Kerosene	4,900 (\$0.31)	6,500 (\$0.41)
Mazut Oil	4,000 (\$0.25)	4,700 (\$0.29)

3. Faced with recent record prices for crude oil worldwide, the GVN has had no choice but to pass the latest price increases to consumers. On August 18, the GVN raised gasoline prices to their highest levels ever, as shown below:

Category	July 3rd Price (VND/liter & USD)	Current Price (VND/Liter & USD)
Gasoline Octane 92	8,800 (\$0.55)	10,000 (\$0.63)
Gasoline Octane 90	8,600 (\$0.54)	9,800 (\$0.61)
Gasoline Octane 83	8,400 (\$0.53)	9,600 (\$0.60)
Diesel	6,500 (\$0.41)	7,500 (\$0.47)
Kerosene	6,500 (\$0.41)	7,500 (\$0.47)
Mazut Oil	4,700 (\$0.29)	5,200 (\$0.32)

This is the second petroleum product price increase this year. Last year there were three price increases. Despite these increases, MOF estimates that the GVN will still have to spend approximately VND 2,500 billion (USD 157 million) on price subsidies for the remainder of the year.

4. Lower prices for refined products in Vietnam have encouraged smuggling into China, Laos and Cambodia. Before the July price hike, petroleum product prices in Vietnam ranged from USD 0.126 to USD 0.269 cheaper per liter than in neighboring countries according to MOF. Faced with the country's porous borders, the GVN remains concerned that petroleum product smuggling will continue for the foreseeable future because prices still remain lower than neighboring countries despite the recent record price increases.

5. With the higher cost of refined petroleum products, costs for sectors dependent on petroleum as an input are also on the rise. For example, after the July increase in prices there was a ten percent rise in input costs in the cement industry; a nine percent rise in the fisheries industry; a 5.72 percent rise in land transportation; a 2.82 percent rise in rail transport sector; and a 1.3 percent rise in the electricity sector. Vietnam Airlines has also imposed a fuel surcharge on international airfares. Prices of basic commodities such as food and foodstuffs have also slightly increased, but the GVN has announced that the prices for three essential items which it sets -- electricity, coal and

cement -- will remain unchanged until the end of this year. The price increases have greatly affected the purchasing power of ordinary Vietnamese, whose average per capita GDP is about USD 550 per year. According to MOF, the GVN is unlikely to meet its targeted CPI of 6.5% for this year because of the August 18 price hikes. According to one press report, the Vietnam Road Administration reported that transport services would be allowed to raise prices by no more than eight percent. As a result, the Vietnam Railway Corporation announced it would raise fares by VND 10,000-50,000 per customer, and more than 200 bus service providers in Ho Chi Minh City agreed to raise all fares by seven to ten percent.

16. Comment: Although Vietnam is an oil producing country, it has no refinery so it must import all refined products, thus exposing itself to world oil price fluctuations. Vietnam plans to build three oil refineries in Dung Quat, Nghi Son and Baria Vung Tao, but in fact, financing for none of these projects has been secured. Serious doubts remain as to the commercial viability of both the Dung Quat and Nghi Son projects. Neither is close to Vietnam's petroleum production sites, and neither is located near major areas of consumption. At the same time, though its transition to a market economy continues, the Government maintains its steadfast determination to intervene in the market to set prices for key commodities. In the case of petroleum products, while the Government has been absorbing the cost of this subsidy, we do not know the complete implications for the budget since the books and hence oil export revenues of state-owned enterprise Petro Vietnam are not publicly available. The price increases, while needed to alleviate budgetary pressures, will place a strain on the economy that is struggling this year to meet growth and export targets. End Comment.

MARINE